

Strategies to Maximize Success in the TSP

**In brief for Kansas City area Federal Employees
Created for the 2023 Calendar Year**

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➤ Link to FEB website for the slides and support spreadsheet:

➤ www.KansasCity.FEB.gov

TSP Success Strategies

Disclaimer: The opinions given here are those of the presenter and are not necessarily those of the KC FEB or the KC FEB Education and Training Committee;

- The purpose of this presentation is to provide some information for Federal employees so that they can make *their own* wise and fully-informed decisions;
- We do not have time to get into the details of how TSP loans or TSP In-Service withdrawals work here, except on a high level. The TSP has printed several pdf pamphlets that go into what TSP loans and TSP In-Service are and their detailed rules, which are beyond the scope of this presentation, due to the restriction of time allocated for this;

TSP “Background, in Brief”

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Brief background on the TSP:

The TSP is a retirement savings plan for Federal Employees. It offers the same types of savings and tax benefits that many corporations offer their employees under 401(k) plans. The hallmark of this plan initially was to allow employees to make pre-tax contributions to retirement funds and help better control their own retirement and match private sector options available.

When the legislation was passed that created the TSP, the Congress was moving away from the CSRS retirement plan to the FERS retirement plan, with Social Security as another leg of the ‘retirement stool’. More on that in the next slide...

TSP “Background, in Brief”

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Brief background on the TSP:

The hallmark of the FERS retirement system is that :

The Federal employee would take more responsibility for their own retirement. FERS retirement system was to have 3 base retirement components:

- 1) The FERS annuity. It is calculated based on the high three successive years of base earnings as a federal employee (this is the *defined benefit component* of a federal employee’s retirement);
- 2) Social Security. The employee is normally eligible for this at age 62, with the ‘full retirement’ age at or near age 67 (this is the *safety-net component* or base income layer for federal retirees under FERS);
- 3) The Federal Thrift Savings Plan. (This component is our discussion topic for today, the *defined contribution component*.);

Many people have other retirement income sources, such as IRA’s, real estate, CD’s, bonds, annuities, stocks & investments, real estate, business income, etc.

TSP –how to maximize your account balances, Discussion Points:

- 1) TSP—what is its real purpose**
- 2) Choose Your Contribution Type with the end goal and strategy (retirement) in mind; Tax Deferred vs. Tax Free**
- 3) Contribution Amounts (why does this matter?);**
- 4) Portfolio Balancing (what it is and why is it so important);**
- 5) TSP Loans (what are they and how do they affect my TSP balance);**
- 6) TSP Withdrawals (when are they appropriate and when are they not appropriate);**

TSP “What is it designed for, its purpose?”

The TSP is designed to provide an additional income component in retirement to make a much more comfortable retirement for the *FERS retiree*. It is focused on that as its primary purpose. Staying focused on that purpose will help the federal employee get the best outcome.

What the TSP is not for:

- It is NOT savings for a new home or lake house;
- It is NOT savings for a vacation;
- It is NOT savings for medical expenses;
- It is NOT savings for education;
- It is NOT savings for large purchases (e.g., a new car or home addition);

If those are your goals, put more money in savings or get a home mortgage or HELOC and, if need be, put a little less in the TSP at least initially and fund those separately and/or later on in life. Do not mingle retirement funds with non-retirement funds.

A little mature ‘budget discipline’ here will go a LONG way!

TSP—What is the purpose, cont'd

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Why should I not use TSP funds for the items above?

To answer that, we want to talk about a concept that I ran into in my college economics class...the concept of **opportunity cost**.

Anyone that has taken even one college economics class knows that this refers to the comparison of one opportunity versus another since you often cannot do both. It then compares those opportunities and determines what the lost opportunities are amongst them.

For example, (this is a mostly non-financial comparison) I could go to the lake and relax over the weekend or I could stay home and go to a birthday party. I can do one or the other but probably not both. If I go to the lake, I have some benefits and if I stay home and go to the birthday party, I have those benefits. So, when we compare the two opportunities, each has an opportunity cost (lost opportunity) associated with it.

TSP Contribution Types Regular TSP vs Roth TSP

Which is better and why:

Regular TSP

- **Pros:** defer taxes now on money you put in retirement
- **Cons:** Taxes historically tend to go up so they could be higher later on in life...and income usually does not go down for a lot of people in retirement. A lot of Social Security income gets taxed in retirement. The Roth can avoid some of this.

Roth TSP

- **Pros:** You can better plan for retirement if you deal with some of the taxes now. This eliminates the surprises later on in life.
- **Cons:** You pay more taxes now and some are struggling to pay bills at the current time.

Generally, the Roth is better, all other things being equal although some retirees (a few) could benefit by doing Regular over Roth in their retirement. Everyone's situation is different...

TSP—Contribution Amounts

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The general rules here are as follows:

- **The more you put into the TSP earlier in your career, the better, due to the longer time horizon for the money to grow;**
- **So, a 20-something that puts in 10% of their earnings will likely double the TSP balance of a 30-something that starts later, doing the same 10%. So the balance for the 20-something will likely double that of the 30-something;**
- **The higher percentage that you put into the TSP, the more you will get into the TSP when you reach your retirement age;**

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[illegible]

TSP—Contribution Amounts, Part II

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How much can I put into the TSP?

➤ **The short answer is “...well, it depends...”**

What does it ‘depend’ on?

➤ **It depends on your age:**

➤ **If you are under age 50 on 12/31/23, then you can put in a maximum of \$ 22,500 for the 2023 calendar year (the payroll year) ($\$ 22,500/26 = \865.38 per paycheck)**

➤ **If you reach your 50th birthday on by 12/31/22 (or earlier), then you can contribute an extra \$7,500 for a total of \$30,000**

➤ **So, if there are 26 pay periods, then that is about \$ 1,154 per paycheck ($\$30,000/26 = \1153.85)**

TSP—Portfolio Balancing

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Portfolio Balancing:

➤ What is it?

- This is simply determining a ratio of how I am investing the money in the 5 TSP options (G, F, C, S & I Funds, plus now the mutual fund window). If you use one of the 'mixed' or age related funds (the 'Life Cycle' or L-funds), you do not have to do this as the TSP's software does this automatically;

➤ Why is Portfolio Balancing so important?

- It is critical because you need to right mix for your 'investment life' to get the proper end result, this takes time-tested strategies based on your risk tolerance and retirement goals and maximizes the results (higher ending TSP balances);

➤ How do I do it?

- For the TSP, you just go into the app. and re-allocate by percentage;

➤ How often should I do it?

- Most financial planning professionals recommend that this be done quarterly;

TSP Loans—what are they and how do they work?

There are 2 types of TSP loans (this is a high level without all the detailed rules and exceptions):

- General Purpose*, and it is for at least \$1,000, has a set-up fee, and runs from 12-60 months but can be paid back sooner.
- Primary Residence*, max of \$50,000 for all loans at any one time;
- A General TSP loan can be for any purpose and is just repaid via payroll withholding from your federal paycheck;
- The Primary Residence loan is for a primary residence and can be repaid via payroll withholding from your federal paycheck;
- When you take out TSP loans they have ‘setup fees’ and they rob your investment balances at a time when they need to be growing and increasing and uninterrupted. The long-term impact on your TSP balances at retirement can be very large;
- I discourage TSP loans because there is usually a better way to accomplish the goals of nearly all of these types of loans.

* go to www.tsp.gov under for all the rules

TSP In-Service Withdrawals—What are those all about?

TSP In-Service Withdrawals*:

➤ What are they?

- They are permanent withdrawals of funds from your TSP balance;
- If from TSP balances, (non-Roth) they are taxable as ordinary income and may be subject to a 10% early withdrawal penalty;
- They permanently reduce the balance you have in the TSP. These are fund balances that you will never recover so your balance at retirement will be permanently lower because of this so this will impact your retirement planning and possibly your retirement date;
- *go to www.tsp.gov under for all the rules;
- I discourage these types of transactions unless there are *no other* options available...

Wrap Up--TSP Maximize

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Summary (these are your *presenter's opinions* but are based on a lot of empirical evidence):

- 1) TSP is for retirement and as a rule, it is NOT for any other purpose (if you need money for other purposes, I recommend that you set that up separately from the TSP);
- 2) The TSP Roth will provide better planning and transparency in retirement over the regular TSP, because it: a) better addresses income and estate taxes and b) it eliminates the need to plan for some income taxes in retirement;
- 3) Putting in the most you can afford, as early in your career as possible and continuing to do so as long as possible at higher rates is the best “strategy for success” (it may not be the only strategy but it is a very, very good one that is time tested based on a lot of research);
- 4) Periodic rebalancing of your portfolio is VERY important. It needs to be done periodically and with regularity because markets change often; Don't try to “time the market”;
- 5) TSP loans, are as a rule, not recommended because they are cost too much to not have the funds in your retirement balance, earning and growing (the lost “opportunity cost” is too high & the lost “opportunity cost” of not being able to contribute for periods of time);
- 6) TSP withdrawals are appropriate and recommended only for either dire emergencies (those not *self-caused*) or, as they were initially intended, *for retirement*.

TSP Maximization Strategies:

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➤ A few Key Takeaways:

- You need a personal or family budget and an emergency savings account before you put much into retirement. This should be slated to cover about 3-6 months' of primary living expenses. This should make it totally unnecessary to take money out of retirement funds. **It is ALL about budgetary discipline.**
- Contribute at least 5% to the TSP (and/or TSP Roth) to get the match/'free money'; I recommend closer to 15% (I do the max and have for a long time);
- Contribute as to the TSP/TSP Roth as early as you can in your career and do it for your whole career (*the presenter recommends TSP Roth almost exclusively, because tax planning is already taken care of—no surprises for those funds later in life when options are limited*);
- Contribute as much as you possibly can afford to your TSP account for a better retirement (assuming growth of the markets, the reason we invest in the TSP in the first place);
- Unlike a Roth IRA, there are **no income limits** with contributions that are made to the TSP Roth;
- If you max out your contributions before the end of the year, however, you could lose out on agency matching contributions for those remaining pay periods;
- Leave those funds in the TSP **untouched** for your career (except possibly for the one-time transfer) to attain a better TSP balance at retirement. So, borrowing from the TSP hurts you in a couple of ways, try to avoid that. You can lose by borrowing and likely not ever recover from that.

TSP Maximization Strategies:

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➤ Key Takeaways, Cont'd:

- If you max out your contributions before the end of the year, however, you could lose out on agency matching contributions for those remaining pay periods;
- Leave those funds in the TSP *untouched* for your career (except possibly for the one-time transfer) to attain a better TSP balance at retirement. So, borrowing from the TSP hurts you in a couple of ways, try to avoid that. You can lose by borrowing and may not ever recover.
- If you take money out of the TSP or an IRA prior to age 59 ½ there is generally a 10% penalty in addition to the tax on the funds withdrawn. This is generally not the case with the TSP Roth;
- Some funds cannot be rolled into the TSP Roth (e.g., Roth IRA funds, currently).
- Funds withdrawn from the TSP are prorated from both fund components based on the balance you have in each (TSP and TSP Roth). This changed in September, 2019. Now you can withdraw from the fund subaccount level, (Regular TSP or TSP Roth portion) as you so choose now;
- My preference would be to take from the Roth funds LAST but that may not always be the best strategy;
- Saving more increases your options for a time when you need them most; Patience and time will build savings to retire with dignity;

TSP Maximization Strategies:

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➤ Key Takeaways, Cont'd:

- The TSP Roth is better for the longer term and estate planning purposes due to the income tax implications;
 - You could consider converting all TSP balances to Roth prior to age 72, (per the Secure Act) to avoid Required Minimum Distributions (RMD's);
 - There are no RMD's on TSP Roth distributions for the TSP Roth owner in retirement, so there are no tax concerns (except for the agency match component, which went into your TSP account 'pre-tax');
 - Most people do not understand that most of their Social Security (up to 85%) is taxed as ordinary income in retirement. This changes most retiree's tax situations. Most federal employee's Social Security income will be partially taxed. So, the TSP Roth can really help the federal employee if they understand this situation and act consistently and prudently;
 - Agency matching contributions have never been taxed for income tax purposes so they are considered 'pre-tax' and will likely be taxed in retirement, when withdrawn (this includes TSP Roth contributors for the agency match portion only, e.g., CERS);
 - If you choose to exchange your TSP balance for a Met-Life annuity at retirement, the money is locked up and you can no longer get to those funds in large amounts. You are giving up a lot of flexibility for the rest of your life if you choose the annuity route.
 - [Report: Dry-up of Social Security Fund Could Trigger Large Benefit Reductions, Tax Increases \(fedweek.com\)](#)

- 1) TSP—what is its real purpose**
- 2) Choose Your Contribution Type with the end goal and strategy (retirement) in mind both as to type and amounts;**
- 3) Contribution Amounts (generally speaking, more is better);**
- 4) Portfolio Balancing (this is the key to long-term growth);**
- 5) TSP Loans (ways in which they hurt your ending TSP balances);**
- 6) TSP Withdrawals (these are generally not recommended);**

Plan your Strategy TSP (tax-deferred) or TSP Roth

1) Options under the TSP:

- Choose TSP (tax deferral) TSP-Roth or both;
- The combined limits is the same for all, in total, based on your age;
- You cannot move money between the TSP and TSP Roth, although you can have both;

2) TSP (tax deferral) or TSP (permanent tax deferral)-which best suits your situation?

- Currently in a Low tax bracket? TSP-Roth is a great option. You pay:
 - Income tax is paid today on the money you contribute;
 - No tax on any of it is ever paid again (if you follow the rules)
- Currently in a High tax bracket? TSP (tax deferral) is a great option. You Pay:
 - No income tax is paid today
 - Income Tax is paid on the principal and on the earnings at retirement (deferral until retirement).

3) Still Cannot Decide? Do a combination of the 2, say 50:50

4) Consider the TSP-Roth if:

- You think taxes will increase in the future for you, especially that will be more than your current tax bracket;
- Income limits prevent you from contribution to the Roth IRA (there are 'workarounds' for this, though).

Tax Savings Options

| Comparison of Tax-saving Options | | | | | |
|--|----------------------|---------------------------------------|---|--------------------------------------|--|
| Type of Account: | Income Tax Paid NOW? | Income Tax Paid Later, at Retirement? | Any Income Limits to Contribute? | Is this Good if Low Tax Bracket Now? | Is this Good for Retirement--lower future tax bracket? |
| Traditional or regular IRA (tax deferral until retirement) | No | YES, principle & interest | Yes | No | Yes |
| Traditional TSP (tax deferral until retirement) | No | YES, principle & interest | No, all employees can participate | No | Yes |
| Roth IRA | Yes | NO, neither principle or interest | Yes, but higher than regular IRA limits | Yes | No |
| TSP-Roth | Yes | NO, neither principle or interest | No, all employees can participate | Yes | No |

Note: your money grows each year without being taxed for all of the above options.

Strategies to Maximize Success in the TSP

(Other charts and materials to supplement this will be posted to the FEB website please check these out)

Remember: this is way more than just about your TSP, it is about:

- your future,
- your retirement;
- your tax situation;
- your estate;

and how to plan *successfully* for all of those

Any Questions??

(please message or email those into the webinar)